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King v. Burwell and the Mandates: What Happens If the Supreme Court Rules Against the Administration?

Andrew Kloster and Alden F. Abbott

Abstract

If the plaintiffs in King v. Burwell *are successful, an Obama Administration rule granting certain premium tax credits to those who obtain insurance through federal health care "exchanges" will be struck down. Absent action by the federal government or states, a ruling for the plaintiffs and against the Obama Administration would mean that individuals for whom insurance coverage became a greater out-of-pocket expense (exceeding 8 percent of their income in any given month) without the premium support tax credit would become exempt from the individual mandate. Furthermore, employers in states that refused to set up Obamacare exchanges would be exempt from the employer mandate because no federal outlays would be made to trigger the penalty.* King *is a consequential initial step on the road toward dismantling and replacing the ill-considered Obamacare statutory scheme.*

On March 4, the Supreme Court of the United States heard oral argument in *King v. Burwell*.[1] This case is a challenge by individuals (petitioners) who do not wish to comply with the so-called minimum coverage provision of the Patient Protection and Affordable Care Act (ACA or Obamacare).[2]

If the plaintiffs are successful, an Obama Administration rule granting certain premium tax credits to those who obtain insurance through federal health care "exchanges" will be struck down.[3] While such a decision would have a direct effect on the availability of subsidies, this memorandum assesses the legal implications for other provisions of the statute, particularly the ACA's employer and individual mandates.

Key Points

- *King v. Burwell* is a challenge to the IRS's final rule that extended the Obamacare exchange subsidies to otherwise qualifying individuals who purchase coverage on the federal exchange, not just state exchanges. This regulation led to a series of lawsuits by individuals aggrieved by the IRS rule.
- The plaintiffs in *King* are residents of Virginia, which has declined to establish a state exchange. They claim a financial injury deriving from the IRS rule because if they are eligible for the premium tax credit, they must either purchase coverage or pay a fine.
- If the plaintiffs are successful, an Obama Administration rule granting certain premium tax credits to those who obtain insurance through federal health care "exchanges" will be struck down.
- While such a decision would have a direct effect on the availability of subsidies, there are serious legal implications for other provisions of the statute, particularly the ACA's employer and individual mandates.

This paper, in its entirety, can be found at **http://report.heritage.org/lm149**

The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002
(202) 546-4400 | heritage.org

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The Obamacare Mandates

The Affordable Care Act, commonly known as Obamacare, seeks to increase the proportion of Americans covered by health insurance. It does this by establishing a new regulatory system centered on an "individual mandate" and an "employer mandate." The individual mandate requires that individuals (with some exceptions) must obtain health insurance coverage that meets new federal minimum standards or otherwise pay a fine. The employer mandate requires that employers with 50 or more employees must offer their full-time employees and their dependents health insurance coverage that meets minimum federal standards. The employers must also limit employee contributions toward the cost of that coverage to levels that are deemed "affordable" or otherwise pay a fine.

Individuals who do not obtain health insurance from their employer may buy it on "exchanges," state-based health insurance marketplaces created by Obamacare whose insurance plans must meet federal regulatory standards (with the plans categorized by "actuarial value" in tiers labeled "bronze," "silver," "gold," and "platinum"). Obamacare provides that if a state refuses to establish an exchange, the federal government will do so.

To help offset the cost of insurance, the Obamacare statute specifically states that lower-income individuals whose incomes fall within a set range are eligible for premium assistance tax credits to purchase health insurance "through an Exchange established by [a] State."[4] The text of the statute, however, does not say that such credits are available for purchases made through exchanges established by the federal government.[5]

Nevertheless, in 2012, the Internal Revenue Service (IRS) issued a rule saying that the tax credits are available for purchases not just under state exchanges, but also in the (currently 34) states in which the federal government operates the exchange. It is estimated that in 2015, roughly 5.5 million people in those states will receive subsidies for insurance purchased through the federal exchange.[6]

This complicated system of mandates, penalties, and subsidies has created unforeseen economic dislocations.[7]

King v. Burwell

King v. Burwell is a challenge to the IRS's final rule that extended the Obamacare exchange subsidies to otherwise qualifying individuals who purchase coverage on the federal exchange, not just state exchanges.[8] This regulation, which inspired critical legal commentary,[9] led to a series of lawsuits by individuals aggrieved by the IRS rule.

The plaintiffs in the *King* case are residents of Virginia, which has declined to establish a state exchange. The plaintiffs apparently have incomes low enough that they are not required to purchase health insurance under the individual mandate provision of the law but high enough that receiving a tax credit to purchase insurance will result in the imposition of a tax penalty if they fail to do so.[10] That

1. 759 F.3d 358 (4th Cir. 2014), *cert. granted*, 83 U.S.L.W. 3102 (U.S. Nov. 7, 2014) (No. 14-114).
2. 42 U.S.C. § 18022(e). There are two related cases currently held in abeyance before the United States Courts of Appeals for the Tenth and District of Columbia Circuits. Pruitt v. Burwell, No. CIV-11-30-RAW, 2014 WL 4854543 (E.D. Okla. Sept. 30, 2014) (held on appeal in abeyance before the 10th Cir.); Halbig v. Burwell, 758 F.3d 390 (D.C. Cir. 2014) (later vacated and held in abeyance pending *King*).
3. There is no indication of alternative relief at this time.
4. 26 U.S.C. § 36B.
5. 42 U.S.C. § 18041(c).
6. *See* Edmund F. Haislmaier, *King v. Burwell: Assessing the Claimed Effects of a Decision for the Plaintiffs*, Heritage Foundation Issue Brief No. 4349, Feb. 20, 2015, *available at* http://www.heritage.org/research/reports/2015/02/king-v-burwell-assessing-the-claimed-effects-of-a-decision-for-the-plaintiffs.
7. *See, e.g.*, Edmund F. Haislmaier, *Impact of King v. Burwell: The ACA's Key Design Flaws*, Heritage Foundation Issue Brief No. 4350 (Feb. 20, 2015), *available at* http://www.heritage.org/research/reports/2015/02/impact-of-king-v-burwell-the-acas-key-design-flaws.
8. 76 Fed. Reg. 50931, 50934 (Aug. 17, 2011); 77 Fed. Reg. 30377, 30387 (May 23, 2012).
9. Jonathan H. Adler & Michael F. Cannon, *Taxation Without Representation*, 23 Health Matrix 119 (2013), *available at* http://law.case.edu/journals/HealthMatrix/Documents/23HealthMatrix1.5.Article.AdlerFINAL.pdf.
10. *See* Brief for Petitioners at 9, King v. Burwell, 759 F.3d 358 (4th Cir. 2014), *cert. granted*, 83 U.S.L.W. 3102 (U.S. Nov. 7, 2014) (No. 14-114), *available at* https://cei.org/sites/default/files/KING%20v%20BURWELL%20-%20No.%2014-114%20-%20Petitioners%20Opening%20Brief%20of%20the%20Merits%20-%20December%2022%202014.pdf.

is because for them, the premium for a basic unsubsidized health insurance policy would exceed the 8 percent "share of income" threshold above which an individual qualifies for an "affordability" exemption from the individual mandate. However, the statute also stipulates that the determination of affordability is based on the premium for the applicable plan "reduced by the amount of the credit allowable under section 36B."[11] In other words, the plaintiffs claim a financial injury deriving from the IRS rule because if they are eligible for the premium tax credit, they must either purchase coverage or pay a fine.

Why might the federal government move to hand over money unauthorized by statute? The answer is that the Administration had assumed that states would set up their own exchanges and counted on their doing so for Obamacare to work. The federal government cannot compel states to do so, however,[12] and a majority of states chose not to,[13] moved partly by a groundswell of political opposition to the law and partly by the costs the system could impose on state budgets. Unsurprisingly, a number of state governors and legislatures rejected Washington's "free" money.[14]

But as the government itself now argues, the health care law is "predicated on tax credits subsidizing the purchase of insurance."[15] Without the tax subsidies being available on the federally established exchange and not just the state exchanges, it is claimed that coverage would become unaffordable for many individuals, and the entire health care law would therefore collapse. This undoubtedly is the overriding policy reason behind the IRS regulation to hand tax subsidies to those who are not entitled to such government largesse.

A policy preference—even a very large one—does not, however, translate directly into a legal argument. All legislative power is vested in the Congress, and a deviation from the text of a law by a coordinate branch of the federal government has serious constitutional implications.[16] For this reason, in interpreting statutes, courts deviate from the plain meaning of a statute only in "rare and exceptional circumstances"[17] where it is clear that the intent of Congress was such that the letter of the statute should not prevail because following the letter of the statute would lead to some absurdity that Congress clearly never intended.[18]

In defending its actions, the federal government has claimed that it is an absurdity to believe that the health care law did not contemplate premium support subsidies for those who are enrolled on the federal exchanges.[19] In the government's view, it is clear that in context, the statutory language "an Exchange established by the State" is a term of art that also includes exchanges established by the federal government.[20]

There are good reasons, however, why Congress might well have intended the law to make subsidies

11. 26 U.S.C. § 5000A(e)(1)(B)(ii).

12. "Congress cannot compel the States to enact or enforce a federal regulatory program.... [S]uch commands are fundamentally incompatible with our constitutional system of dual sovereignty." Printz v. United States, 521 U.S. 898, 935 (1997); *see also* New York v. United States, 488 U.S. 1041 (1992).

13. Sarah Kliff, *It's Official: The Feds Will Run Most Obamacare Exchanges*, Wash. Post, Feb. 18, 2013, *available at* http://www.washingtonpost.com/blogs/wonkblog/wp/2013/02/18/its-official-the-feds-will-run-most-obamacare-exchanges/.

14. *Id.* The law offered states federal grants to pay for designing and building the exchanges but clearly stipulated that they had to be financially self-sustaining from Jan. 1, 2015, onward. *See* 42 USC § 18031(d)(5)(A).

15. Brief for the Respondents at 6–8, King v. Burwell, 759 F.3d 358 (4th Cir. 2014), *cert. granted*, 83 U.S.L.W. 3102 (U.S. Nov. 7, 2014) (No. 14-114).

16. U.S. Const. art. 1.

17. Tennessee Valley Auth. v. Hill, 437 U.S. 153 (1978), fn. 33.

18. Church of the Holy Trinity v. United States, 143 U.S. 457 (1892).

19. Brief for Respondents, *supra* note 15.

20. The government gives several reasons for this "clarity." First, where states do not establish state exchanges, the federal government shall "establish and operate *such exchange* within the State." *Id.* (citing 42 U.S.C. § 18041(c)(1) and adding emphasis). In other words, the exchange established and run by a state is identical with an exchange established and run by the federal government, forgetting separate statutory authorizations, separate funding, and separate regulations and requirements. Second, and "most strikingly" for the government, a "qualified individual" eligible to shop for insurance on an exchange is one who "resides in the State that established the exchange." 42 U.S.C. § 18032(f)(1)(A). According to the government, the plain language of the law, as argued by the petitioners, would render no one in states with federal exchanges "qualified" to purchase insurance on the exchanges. However, the petitioners argue both that the government's argument is circular and that the "qualified individual" definition is not a limitation on enrollment. *See* Brief for Petitioners, *supra* note 10, at 48–49.

unavailable to those who purchase insurance on the federal exchange. Most important, the unavailability of subsidies on the federal exchange puts strong pressure on state governments to set up their own exchanges. What government lawyers now count as evidence of drafting error or absurdity might be a key feature of the law: an example of the government's offering money to induce states to comply with a program that would otherwise be beyond the constitutional authority of the federal Congress.[21]

Yet even were this not what Congress intended, it surely demonstrates that a court construing the phrase "established by [a] State" to mean established by a state is not a manifest absurdity. In defending its tortured reading of the law, the government is required to make an "extraordinary showing" before allowing for "judicial rewriting of an act of Congress," as the United States Court of Appeals for the District of Columbia Circuit noted in its panel decision in a related case, *Halbig v. Burwell*.[22]

Citing a recent Supreme Court decision, the D.C. Circuit stated that "an agency may not rewrite clear statutory terms to suit its own sense of how [a] statute should operate."[23] Writing (and rewriting) laws is the constitutional prerogative of Congress through the Article I process, even where laws might "seem odd." Therefore, "with reluctance," that panel granted summary judgment to the plaintiffs:

> At least until states that wish to can set up Exchanges, our ruling will likely have significant consequences both for the millions of individuals receiving tax credits through federal Exchanges and for health insurance markets more broadly. But, high as those stakes are, the principle of legislative supremacy that guides us is higher still. Within constitutional limits, Congress is supreme in matters of policy....[24]

Just so, but was the D.C. Circuit correct in assuming that the consequences of its ruling would be "significant?" And what happens if the Supreme Court strikes down the IRS rule? Aside from the loss of subsidies, are there other effects of such a ruling?

The Individual Mandate and the Tax Credit

As noted, the plaintiffs themselves claim that their standing to bring suit in the *King* case derives from the fact that the availability of a tax subsidy on the federal exchange reduces the cost of coverage relative to their incomes to such a point that they become liable for either purchasing coverage (and paying the portion of the premium in excess of the subsidy) or paying a fine.[25] In other words, a ruling for the plaintiffs by the Supreme Court will have as a part of its holding a determination by the Court that the individual mandate tax penalty is contingent upon the availability of the section 36B premium support tax credit. How might this be so?

The individual mandate is a part of Obamacare that requires all individuals to purchase health insurance.[26] Failure to purchase "minimum essential coverage" for any given month incurs a "shared responsibility payment," which is a tax penalty.[27] The amount of the tax penalty is calculated to provide incentives to purchase health insurance and is the greater of either the fixed amount or the percentage of the taxpayer's income as specified in the statute.[28]

21. This public choice phenomenon has led one former federal appeals judge and Senator to call for the abolition of this type of federal spending. *See* James L. Buckley, Saving Congress from Itself: Emancipating the States and Empowering Their People (2014). Federal inducements have occasionally risen to the level of a "gun to the head" of states. Nat'l Fed'n of Indep. Bus. v. Sebelius, 132 Sup. Ct. 2566, 2604 (2012).
22. 758 F.3d 390 (D.C. Cir. 2014) (later vacated and held in abeyance pending *King*). This extraordinary showing stems both from constitutional separation of powers concerns and federal statute, specifically the Administrative Procedure Act (APA), 5 U.S.C. § 500 *et seq*. The APA is the federal law creating a private right of action to challenge administrative actions that are contrary to law and is the basis for each of the lawsuits challenging the IRS rules. 5 U.S.C. § 706(2)(A).
23. *Id.* at 40 (citing Utility Air Reg. Group v. EPA, 134 Sup. Ct. 2427, 2446 (2014)).
24. *Id.* at 41.
25. Of course, they can choose not to purchase health insurance and instead pay the tax penalty, but in doing so they would also forgo the premium support tax credit.
26. 26 U.S.C. § 5000A.
27. 26 U.S.C. § 5000A(b).
28. 26 U.S.C. § 5000A(c).

Presumably, a low-income individual failing to purchase health insurance could face damaging penalties. Therefore, the health care law contains an affordability exemption: "Any applicable individual for any month if the applicable individual's required contribution (determined on an annual basis) for coverage for the month exceeds 8 percent of such individual's household income" is exempt from the mandate.[29]

As defined by the statute, "required contribution" means the share of the premium that the enrollee must pay, derived through a calculation that directly references the premium support tax credit at issue in *King*:

> [I]n the case of an individual eligible only to purchase minimum essential coverage…[required contribution means] the annual premium for the lowest cost bronze plan available in the individual market through the Exchange in the State… reduced by the amount of the credit allowable under section 36B for the taxable year….[30]

Setting aside the fact that this provision contains almost exactly the same phrase as the one at issue in the *King* case,[31] it is clear that if the tax credit in section 36B were unavailable for those who purchase insurance on the federally established exchange, which is what would happen if the plaintiffs in *King* prevail, the required contribution would increase to the *full* amount of the unsubsidized premium. Presumably, if the required contribution went up, a number of individuals would suddenly become eligible for the affordability exemption.

The Employer Mandate and the Tax Credit

The employer mandate is even more clearly affected by the *King* case. The health care law notes that large employers, defined as those who employ an average of 50 full-time employees or more during a calendar year, either must provide minimum essential coverage to employees or, if they elect not to do so, must not have any employee receiving a premium support tax credit or cost-sharing reduction.[32]

In other words, a penalty will be assessed to any employer that fails either to provide health insurance that contains the minimum essential coverage or to pay wages that are high enough that no single full-time employee is eligible for federal monies. Obviously, if the tax credit is unavailable in a state where the federally established exchange operates, a relevant employer can be penalized only if one of its full-time employees receives a cost-sharing reduction.

As it turns out, however, the cost-sharing reductions in the health care law are predicated on the availability of the premium support tax credit.[33] Those who are eligible for cost-sharing reductions closely mirror those who are eligible for the tax credit.[34]

Thus, if the plaintiffs in *King* are successful, most of those who are affected will also be "eligible insured" for the purposes of the cost-sharing subsidies. However, the law contains a section with "definitions and special rules" that reads, in pertinent part:

> **(2) Limitations on reduction**
>
> No cost-sharing reduction shall be allowed under this section with respect to coverage for any month unless the month is a coverage month with respect to which a credit is allowed to the insured (or an applicable taxpayer on behalf of the insured) under section 36B of such title.

29. 26 U.S.C. § 5000A(e)(1)(A).
30. 26 U.S.C. § 5000A(e)(1)(B)(ii).
31. "Exchange in the State." *Id.* While this omits the phrase "established by" and therefore is distinguishable and perhaps strengthens the position of the plaintiffs in *King*, there is an argument to be made that a finding for the plaintiffs in *King* could invalidate this section as well.
32. 26 USC § 4980H.
33. 42 U.S.C. § 18071.
34. Those who are eligible are those who enroll in a silver-level plan on an exchange and whose household income exceeds 100 percent but does not exceed 400 percent of the federal poverty line. The eligibility requirements for the cost-sharing reductions are similar to those for the premium support tax credit, except that the tax credit is available for those *at* 100 percent of the federal poverty line as well. Those who are described in section 36B(c)(1)(B) are treated as having household income at 100 percent of the federal poverty line and therefore ineligible for cost-sharing. This group of individuals represents those who are lawfully present aliens at or below 100 percent of the federal poverty line but ineligible for Medicaid. *See* 26 U.S.C. § 36B(c)(1)(A).; 42 U.S.C. § 18071(b); 26 U.S.C. §36B(c)(1)(B).

What this means is that if the plaintiffs in *King* are successful, no cost-sharing reduction payments shall go out, and, therefore, no employers will meet the requirements for them to pay the penalty. The employer mandate, in other words, seems clearly tied to the availability of the premium support tax credits, and in states where the federally established exchange operates, it might be that very few, if any, employers will be subject to the employer mandate in the wake of a decision against the Administration in *King*.[35]

As a matter of incentives, this result makes some sense. Without federal subsidies of health insurance purchases on the exchanges, the employer–employee compensation relationship will remain the same. Employers will still be dissuaded from dropping employee health insurance coverage if that decrease in benefits will likely prove detrimental to their ability to attract labor.

In a market with premium support subsidies and cost-sharing reductions, however, the employer would face little or no deleterious labor effect by dropping coverage, because each employee would obtain this compensation from the federal government. In that market, the employer mandate might have been an essential cog in the machine. In a post-*King* world, however, there is no need for the employer mandate.

Conclusion

Absent action by the federal government or states, a ruling for the plaintiffs and against the Obama Administration in *King* would likely have the following outcomes for employers and individuals affected by the case:

1. Individuals for whom insurance coverage became a greater out-of-pocket expense (exceeding 8 percent of their income in any given month) without the premium support tax credit would become exempt from the individual mandate.

2. Employers in states that refused to set up Obamacare exchanges would be exempt from the employer mandate because no federal outlays would be made to trigger the penalty.

In sum, *King* is a consequential initial step on the road toward dismantling and replacing the ill-considered Obamacare statutory scheme.

—***Andrew Kloster*** *is a Legal Fellow in the Edwin Meese III Center for Legal and Judicial Studies, and* ***Alden F. Abbott*** *is Deputy Director of the Meese Center and John, Barbara, and Victoria Rumpel Senior Legal Fellow, at The Heritage Foundation.*

35. The sole exception might be if an employer operates in a state with the federal exchange but employs somebody who lives, say, in an adjoining state with a state-based exchange.